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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 1057

INLAND STEEL COMPANY, A CORPORATION,
Petitioner,

vs.

FOREMAN M. LEBOLD AND SAMUEL N. LEBOLD,
Respondents.

REPLY OF PETITIONER IN SUPPORT OF ITS PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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I.

THE CONFLICT BETWEEN THE TWO DECISIONS OF THE SEVENTH CIRCUIT COURT OF APPEALS.

Petitioner respectfully insists that the first decision directed that it might proceed with its planned dissolution and that the second decision held that it had committed a fraudulent breach of trust in so doing.

It is self-evident that if a parent corporation cannot dissolve its solvent prosperous subsidiary and purchase its assets at the dissolution sale unless it pays to the minority the value of its interest capitalized on an earning basis, then to all intents and purposes the subsidiary cannot be dissolved at all. Dissolution is liquidation and that is not liquidation. The case at bar is an illustration. Steamship Company was paying about 100% dividends annually.

The second decision holds that, since Steel Company bought the assets at the dissolution sale, it must pay the value of the minority's stock capitalized on an earning basis, or somewhere in the neighborhood of $2000 per share. the equivalent of 20 years dividends of 100%. Undoubtedly, the effect of the decision is to deny the right of the majority to dissolve, if it intends to purchase the assets at the sale.

We submit that the first decision did not even intimate this to be the rule, much less hold it.

Respondents concede that Steel Company clearly and explicitly stated that it planned to dissolve Steamship Company and purchase its ships for $1,120,000 so that it could carry its freight at cost. When respondents attacked the plan in the first case, claiming it was fraudulent, the District Court held (1) that the plan contemplated a *bona fide* dissolution, (2) that the dissolution of the company and sale of the assets as planned would not perpetrate a fraud on the minority, (3) that the dissolution should proceed and the assets be sold to the highest and best bidder, and (4) that Steel Company might bid at the sale (R. 169, 170). The Circuit Court of Appeals affirmed the chancellor; it did not hold those findings erroneous in any respect. On the contrary it held that a majority stockholder may dissolve the corporation regardless of motive or expediency, that such a stockholder is not always a trustee although he may become such because of his conduct, that the majority stockholder can force a sale of the assets to himself for a fair price, that a court of equity may not interfere with the right of the majority to force a dissolution and sale unless the evidence discloses an unfair advantage taken over the minority. Now, in the second decision the Circuit Court of Appeals holds that (1) the consummation of the plan did not accomplish a *bona fide* dissolution, (2) that the plan was fraudulent in purpose and (3) that its accomplish-

ment in a manner exactly as discussed in the first case amounted to a fraudulent breach of trust and a perpetration of a fraud on the minority. It could not have failed to order an injunction in the first case if its view then was that announced in the second case. Therefore, as we stated the first decision *necessarily* approved the dissolution plan.

Respondents necessarily admit that if the dissolution plan was fraudulent the court could have enjoined it in the first case. However, they advance the novel proposition that because the plan had not yet been executed the court could in its discretion refrain from enjoining it but could permit the dissolution to proceed and condemn it after it was consummated.

This seems unconscionable. Certain it is that petitioner did not interpret the decision as a condemnation of the plan. It would not have been so devoid of reason as to have defied the court and proceeded with a plan held fraudulent. The Master did not so interpret the decision. The District Court did not so interpret it.

Respondents state that the court did not hold in its first decision that the Steel Company might proceed. What did the court mean when it said "proceed to a dissolution"? Did it mean "dissolve but do not carry out the rest of the plan because it is fraudulent"? Did it mean "dissolve but do not purchase the ships even at full value because you are a trustee and that would be a breach of trust"?

We submit that when the court stated that the chancellor "rightfully held that the evidence does not make a case within the principles which we have outlined above" that "not all the essentials necessary to a complete case are present. There has as yet been no disposition of the assets or loss to the minority," that "Though the court was justified in its conclusion that the facts thus far do

not amount to fraud it by no means follows that what may develop in the future may not bring about such an injury to appellants as will justify a renewal of their appeal to the chancellor'' the court was not condemning the plan, was not stating that if Steel Company went any farther with its announced purpose it would be guilty of fraud, but was leaving open the door in case fraud occurred in the method or manner of considering the sale and distribution.

When the court stated in the final paragraph:

> ''The court was justified in its conclusion that the presently developed circumstances are not such as to create a cause of action in appellants, and the decree, therefore, should be affirmed. But this affirmance and the dismissal by the court below will be without prejudice to the right of appellants hereafter to present the facts herein presented in connection with such other facts, if any, as bring about a situation within the doctrine recognizing causes of action in minority stockholders.''

the presently developed circumstances there referred to were not only the intention to dissolve, but also the intention to purchase the assets at the dissolution sale for $1,120,000. To what was the court referring when it stated that the minority stockholders could present their case again if other facts developed which gave rise to a cause of action by minority stockholders? It must necessarily have been something other than the then developed circumstances. Respondents must admit that no ''other facts'' than those in contemplation at the beginning, did occur which would give rise to a cause of action by minority stockholders. Respondents cannot deny that the court indicated that a purchase by the majority for a fair price was proper (p. 354). Nor can they deny that the courts only expressed fear was that the majority would ''force dissolution and liquidation of assets and thus produce an opportunity to purchase at a satisfactorily low market price **all the physical assets**'' (p. 355) and that it

was that unwarranted fear that caused the court to invite the minority to return if such a thing occurred.

Respondents cannot contend that the Court in the first decision ruled or intimated that it would be fraudulent for Steel Company to purchase the ships unless it paid going concern value for the minority interest at a liquidation sale, or that purchasing the ships at their full value would constitute appropriating the minority's interest without compensation. Yet in the second decision the court condemns Steel Company simply and solely because it bought the ships. What other act of Steel Company caused it and its officers to be scathingly denounced as violators of sacred trusts and decreed to be mulcted in huge damages? If those assets had been purchased by a third party, the minority would have received exactly what it has now received. If respondents themselves had purchased the ships they would not have paid more than what Steel Company paid. They do not contend that the purchase of the ships by them or by a third party would have entitled them to carry Steel Company's freight.

II.

THE CONFLICT BETWEEN CIRCUITS.

In response to petitioner's point that there is a direct conflict between the holding of the court in the First Circuit in the case of *May* v. *Midwest Refining Co.*, 121 Fed. (2d) 431, and the instant case in the Seventh Circuit on the question as to whether a majority stockholder commits a fraudulent breach of trust when it causes the corporation to be dissolved, over the protest of the minority, and purchases the assets for a fair price at the dissolution sale, respondents attempt to avoid the conflict by contending that in *May* v. *Midwest Refining Co.* adequacy of consideration was not involved.

We respectfully submit that adequacy of consideration is not involved in the case at bar. Respondents argue circuitously. They assume their conclusion. If it be assumed that it is entirely right and proper for a majority stockholder to purchase the assets of its subsidiary at a dissolution sale, then Steel Company paid the full fair price for the ships—$1,120,000. If it be assumed that it is wrong for a majority stockholder to make such a purchase, then, according to the Seventh Circuit Court of Appeals, Steel Company should have paid about $3,200,000. It is only upon the assumption of wrongdoing by Steel Company that inadequacy of consideration can be argued. The claimed wrong was the act of purchasing the assets by a majority stockholder whom the court regarded as a trustee. However, *May* v. *Midwest Refining Co.* holds that such a purchase is not a fraudulent breach of trust, even though the majority stockholder be regarded as a trustee. If that case is followed, the right to purchase is established, and no claim of inadequacy of consideration is possible. The legality of the act of purchase establishes the adequacy of consideration. If the lower court in the instant case is followed, then it was a fraudulent breach of trust for Steel Company to buy the ships. Both decisions cannot be right.

Naturally, respondents are reluctant to concede that the lower court found that a fraud had been committed merely because the majority purchased the ships, but that is very clear. Suppose respondents themselves had purchased the ships, would they have had to pay more than physical asset value for them? Suppose a third party had been the purchaser? Unless respondents wish to contend that a purchase of the ships by Steel Company was fraudulent if it used them, but not fraudulent if it permitted them to disintegrate from non-use, they must concede that the act of purchasing is the only basis for the lower court's holding that the transaction was fraudulent.

Respondents attempt to avoid this result by contending that Steel Company obtained more than the ships; that in the process of purchasing the ships it appropriated Steamship Company's business. That also is obviously incorrect. At the dissolution sale the ships were Steamship Company's only saleable assets. If respondents themselves had purchased the ships, or if some third party had been the purchaser, neither would have had the disposition of Steel Company's traffic. Steel Company would not have been required to employ those ships for the transportation of its freight. That is the crux of this case and the point which the lower court persistently ignored.

No right to carry Steel Company's freight inhered in the ships, nor passed with the ships to the purchaser, because *there was no contractual relationship of any kind between Steel Company and Steamship Company with reference to the carriage of Steel Company's freight.* Respondents have realized the importance of this, and have attempted to avoid it by asserting, at page 5, that it is a misstatement. On the contrary, those are the words of the stipulation between the parties. (R. 194.) The lower court did not, and in view of the stipulation could not, have found differently. The court stated that "there was no express contract between the two companies, but the tonnage was carried by original arrangement, succeeded by tacit understanding, at the going market rates." The plain meaning of those words is that although Steel Company was not bound to transport its freight via Steamship Company, nor Steamship Company bound to carry such freight, it was at first arranged, and later tacitly understood, that going rates would apply to the freight which was carried. Respondents' anxiety to have those words interpreted as a holding that Steel Company was obligated to ship its freight via Steamship Company and not merely to pay the going rate for what it did ship, indicates that respondents fully understand that adequacy of consideration is not here involved,

because Steel Company's freight business did not follow the ships. If Steel Company had an obligation, express or implied, to give its freight to the ships, no matter who was the purchaser, the court would have said so, and would have held that the District Court was in error in holding as a matter of law that there was no such obligation and no such valuable saleable assets. (R. 226, 229.) Since no conceivable purchaser could have obtained more than the ships, and since the ships brought their full value, adequacy of consideration is not involved. That point being the only one urged in support of the claim that the case in the First Circuit and the case at bar do not conflict, we respectfully submit that the direct conflict between the controlling principles in those two cases is demonstrated.

III.

THE CONFLICT WITH THE WEST VIRGINIA DECISIONS.

Respondents state that petitioner would forget that it is trying to justify its conduct as a trustee. Petitioner does not forget that, but would ascertain the rights of a majority stockholder (parent corporation) of a West Virginia eighty per cent owned subsidiary with reference to the dissolution of such subsidiary. Has such stockholder an absolute right to vote dissolution, *regardless of motive and expediency?* The lower court, in its first decision, held that to be the meaning of the West Virginia statute. If the subsidiary is prosperous and paying dividends, dissolution would stop those dividends, and would naturally be detrimental to the minority. If the subsidiary is a mere incident in the business of the majority stockholder (parent corporation) and the dividends paid to the minority are merely an added operation cost to the parent corporation, the cessation of dividends would be a definite benefit to the latter. Does the fact of such damage to the minority and benefit to the majority prevent the

majority from dissolving the subsidiary? If so, how can a parent corporation ever lawfully dissolve its prosperous going subsidiary over an objecting minority? What becomes of the West Virginia statute? What becomes of the numerous other similar statutes? Can minorities hereafter block reorganization of solvent corporations as they formerly could at common law?

The answer of the Seventh Circuit Court of Appeals to these important questions of local and general corporation law is that the vote of every majority stockholder must be controlled by the guiding question of what is best for the corporation and the minority stockholders, for which he is trustee; that his own selfish interest must be ignored; that when he votes against the interest of the minority and in favor of his own interest, he commits a breach of trust, is faithless to the minority, and merits the condemnation of a court of equity (R. 253). This means that a parent corporation, being a majority stockholder and hence a trustee for the minority, cannot vote in his own interest to dissolve its prosperous subsidiary since dissolution would damage the minority stockholders of the subsidiary. It is not appropriate to argue the merits now except as they bear on questions presented as grounds for granting the writ, but neither the cases cited by respondents nor any other cases so hold, in the face of a permissive statute such as that of West Virginia, where the stockholders' vote is controlling. The important point now is that the Supreme Court of West Virginia, in *Thurmond* v. *Paragon Colliery Co.*, 82 W. Va. 49, 53, 95 S. E. 816, 817, holds that in meetings of shareholders, each shareholder represents himself and his own interests solely, and in no sense acts as a trustee or representative of others. That is the law everywhere. Otherwise the majority could never vote, if its vote detrimentally affected the minority. As respondents indicate (Reply, p. 12), the vote cannot be destructive of the interests of the minority,

but the interests of the minority are merely their proportionate share in liquidation. They have no right to keep the corporation alive, or if it is dissolved, to obtain the going concern value of their interest. The cases hold that the statute which permits the majority to control is a part of their contract with the corporations.

Naturally, if by the dissolution vote the majority assumes control, it becomes a trustee, and must scrupulously protect the minority interest, and accord them ratable distribution of the proceeds of the dissolution sale. That is where the fraud occurred in *Southern Pacific* v. *Bogert*, 250 U. S. 483, and *Jones* v. *Missouri Edison Electric Co.*, 144 F. 765 (8 C. C. A.), cited by respondents and by the court in each of its opinions. It was not in the assumption of control, which was held proper, but in the distribution, which ignored the rights of the minority to their ratable share.

Not only does the Supreme Court of West Virginia hold that stockholders may vote in their own interest and against the interest of other stockholders, but in *Tierney* v. *United Pocahontas Coal Co.*, 85 W. Va. 545, 559, 102 S. E. 249, 255, holds that a majority stockholder may buy the corporate assets for a fair price. Here again we have the West Virginia law, as laid down by the Supreme Court of that State, directly in conflict with the Seventh Circuit, which has held it to be a fraudulent breach of trust for the majority stockholder, a parent corporation, to purchase its subsidiary's assets at the dissolution sale. As to the *Tierney* case, respondents indicate that the purchase price must be adequate. They do not deny that the West Virginia court holds that the majority has a right to purchase. If the Seventh Circuit Court of Appeals had conceded that, their decision would have been for petitioner, Steel Company, because if they had so held they could not have ruled that Steel Company should pay twenty times par for the minority interest, or the equivalent of 100 per

cent dividends per annum for twenty years. This is merely a denial of the right of dissolution. This is not fair play. This is not what *Pepper* v. *Litton* stands for, but we respectfully submit it is what the Seventh Circuit Court of Appeals insists *Pepper* v. *Litton* stands for. If not, why did the court cite it and quote at length therefrom?

IV.

THE QUESTION OF DAMAGES.

What is the value of the business of the transportation company whose only customer is its majority stockholder, which uses the company to carry its freight, when that customer is not bound in any way to continue its business relations with the company, and does not intend to do so, but, on the contrary, intends to, and does, dissolve the company.

The only testimony bearing on this question was uncontroverted and was to the effect that the value of such a business is nothing more than the liquidating value of its physical assets (R. 60-70). Would anyone purchasing the business have paid more than that under the circumstances?

The question was before the court only illustratively and not as a true question of damages, because respondents' bill was dismissed for want of equity. In spite of that, the Seventh Circuit Court of Appeals has now decided the question and has done so in a manner that is obviously erroneous. It has treated the question just as though the corporation could not be dissolved and as though respondent's stock therein had been converted by Steel Company to its own use. Nothing can more clearly illustrate what has happened in this case. The court having held in the first case that the corporation could be dissolved, regardless of motive and expediency, now, in the second case, predicates fraud upon motives only, and in effect holds that the corporation cannot be dissolved at all.

However, the true point, as stated before, is that the court ruled on an issue not yet before it which petitioner respectfully submits it should be permitted to argue before the proper tribunal.

Respectfully submitted,

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